



14 February 2011

David Carrigan
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Inland Revenue Department
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Dear David

Proposal to Remove Over-Taxation of Non-Resident Investment into PIEs

We write in response to your letter of 28 January 2011, seeking our feedback on the proposed design of the Foreign Investor PIE rules outlined in your letter. We understand that after considering feedback on the proposal, the Department intends to introduce a tax Bill later in 2011 to enact the reforms.

The proposal

The Society supports the proposal, both in terms of the pure policy perspective (New Zealand should not tax foreign source income derived by foreigners) and also the economic development perspective (development of New Zealand as a jurisdiction for domicile of offshore funds). These points are developed more fully in our submission dated 4 June 2010, in response to the officials' issues paper *Allowing a zero percent tax rate for non-residents investing in a PIE*, April 2010.

We understand that you have consulted extensively with industry regarding the general shape of the reform, and therefore we have not attempted in this response to second-guess the general approach of the proposed reform. Our comments are more technical in nature.

Residence test for a unit trust may require reform

In order to be a PIE, an entity must be New Zealand resident for tax purposes (Income Tax Act 2007 section HM 8).¹ PIEs are in most cases structured as unit trusts. This means that the bright line test of "place of incorporation" (section YD 2(1)(a)) is not open to them. Rather, they must rely on more factually intensive tests such as centre of management. Some entities that wish to make use of the new regime may have significant elements of their management outside New Zealand. Accordingly, we suggest that consideration be given to whether some reform of the residence definition is necessary for PIEs. The residence definition would serve two purposes – it would provide certainty for the fund, and ensure that the connection with New Zealand was more than "in name" only. For example, a unit trust PIE could be treated as New Zealand resident if it is governed by New Zealand trust law, has a New Zealand resident trustee and/or maintains a register of members in New Zealand.

Source rules will require reform

It will be important to ensure that income from non-New Zealand investments of a foreign investor PIE is not treated as New Zealand source income by virtue of the PIE's activities in New Zealand. For example, for a PIE that is managed in New Zealand, its income from foreign investments may

¹ Section references are to the Income Tax Act 2007 unless otherwise stated.

have a New Zealand source by reason of section YD 4(2) of the Act. Section YD 4(2) treats income derived from a business carried out in New Zealand as New Zealand source income. In addition, subsection (3) (income from contracts made and wholly or partially performed in NZ) and subsection (18) (income from any other source) are potentially of concern, given their wide and somewhat uncertain scope.

Eligibility criteria

With respect to paragraph 11 of your letter, we cannot see how it would “reduce complexity” to deny a foreign investor PIE the right (which other PIEs have) to hold more than 20% of a company, so long as the market value of all such shareholdings does not exceed 10% of the total value of the PIE. On the contrary, having two different rules would increase complexity.

Foreign Investor Zero Rate PIE

In our view a Foreign Investor Zero Rate PIE should be able to hold derivatives entered into with New Zealand counterparties, and derive derivative income, without any limitation of amount, so long as the derivatives are entered into for hedging purposes (cf paragraphs 12 to 14 of your letter). There is no justification for denying a Foreign Investor PIE the ability to enter into derivatives with New Zealand counterparties.

This submission was prepared with assistance from the Society’s Taxation Law Committee. If you wish to discuss this submission further please contact the Taxation Committee Convener, Mr Casey Plunket, through the committee secretary, Julie Smith - phone (04) 463 2967 or email julie.smith@lawsociety.org.nz

Yours sincerely

A handwritten signature in black ink, appearing to read 'Jonathan Temm', written in a cursive style.

Jonathan Temm
President